



HONKAMP KRUEGER & CO, P.C.

CPAs & Business Consultants

Quality Assessment Report

For

Louisville Jefferson County

Metro Government

Office of Internal Audit

December 5, 2011

Table of Contents

	<u>Page #</u>
Executive Summary	3
Introduction	3
The HK Solution	3
Comments	4
Conformity Rating	4
Opportunities and Innovative Practice Suggestions – Summary	5
Appendix - Report Detail	8
Addendum	18

Executive Summary

Introduction

At the request of the Louisville Jefferson County Metro Government (LJCMG or Metro) Interim Director of the Office of Internal Audit, Honkamp Krueger & Co. P.C. (HK) has completed a Quality Assessment of the Office of Internal Audit. We appreciate the opportunity to present the engagement results in the narrative which follows.

The Louisville-Jefferson County Metro Government began operations January 6, 2003. It was created when Jefferson County and the City of Louisville merged to form a consolidated local government which serves a community of 386 square miles and 700,000 residents. Louisville Metro operates under a Mayor-Council form of government providing services to citizens in the 16th largest city in the United States. The Mayor is the top executive and oversees Louisville Metro Government services ranging from police and fire protection to roads and garbage collection, from health clinics and emergency services to parks and recreation. Each year, the Mayor presents the annual spending budget for Metro Government to the Metro Council for review and approval. The Metro Council has 26 members, elected by voters in 26 districts. The council is responsible for enacting ordinances (or laws), and it approves Metro Government's budget. Metro employs about 6,500 full time equivalents and has revenues of about \$665 million.

LJCMG currently has an established internal audit activity lead by the organization's Chief Audit Executive (CAE), the Interim Director of the Office of Internal Audit. Reporting to the CAE are 7 audit professionals. Information technology audits are accomplished using outsourced professional services. The OIA reports jointly to the Mayor and the Metro Council. OIA is responsible for conducting audits of all Metro departments, agencies, offices, boards, activities and other appropriations. Recommendations resulting from OIA's audits are made to the Mayor, Agency Directors and the Metro Council.

The HK Solution

The Office of Internal Audit (OIA) acted to confirm its conformance with the Institute of Internal Auditors (IIA) *Standard* 1312 and the Government Auditing Standards by hiring HK to perform an External Quality Assessment (QA). Specifically, the IIA *Standard* states that all internal audit activities are required to conduct an external assessment every five years in order to provide assurance that the activity is in conformity with the IIA *Standards* and the Code of Ethics. The Government Auditing Standards require a similar exercise to be performed once every three years.

HK utilized proven methodology to execute this QA. As a first step, the OIA prepared Advanced Preparation material and gathered other pertinent data which provided HK detailed information about the organization and the internal audit function. Also, surveys were sent to a representative sample of the LJCMG management team by the OIA with the completed surveys being returned directly to HK. The HK team compared the survey results to historical data available from QAs conducted by the IIA. A summary of the results and accompanying comments (without identifying the individual survey respondents) have been furnished to the CAE.

While on-site, interviews were conducted with the OIA staff and the following LJCMG council members and managers:

<u>Name</u>	<u>Title</u>
Greg Fischer	Mayor
Ellen Hesen	Chief of Staff
Tina Ward Pugh	Chair - Governmental Accountability and Ethics Committee
Kevin Kramer	Vice Chair – Governmental Accountability and Ethics Committee
Bill O'Brien	County Attorney's Office - Civil Division Director
Steve Rowland	Chief Financial Officer
Kellie Watson	Director, Human Resources
Beth Niblock	Director, Information Technology

In addition, the HK team reviewed the OIA risk assessment and audit planning processes, audit tools and methodologies (including information technology), engagement management and staff development processes, and a sample of internal audit work papers and reports.

Comments

We found numerous positive aspects about the LJCMG OIA and the work it performs. As evidenced by interviews, surveys, document reviews, and observations, the OIA currently uses “Innovative Practices” in its audit operations and administration. Some of the more notable positive aspects and practices include:

- Chief Audit Executive has been invited to attend the bimonthly Mayor’s chief and director meetings
- OIA utilizes an outsourcing model to gain subject matter expertise for its planned IT audits
- An anonymous Tip Line (Hotline) has been established providing feedback directly to the OIA
- Overall opinion in audit reports are presented using a heat map approach
- The OIA’s Policy and Procedures Manual is organized around the IIA’s International Professional Practice Framework
- Annual Risk Assessment process is based on COSO model and is well documented

Conformity Rating

The IIA QA framework provides a system for rating conformity to the *International Standards for the Professional Practice of Internal Auditing (Standards)*, which consists of three categories: generally conforms, partially conforms, and does not conform.

The framework describes these categories as follows:

- “Generally conforms” (GC) means that an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the *Standards* in all material respects, but some opportunities for improvement may exist.

- “Partially conforms” (PC) means that practices were noted that are judged to deviate from the *Standards*, but they did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.
- “Does not conform” (DNC) means that deficiencies in practices were judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

The IIA *Standards* are divided into two primary subsets: Attribute Standards and Performance Standards. **The QA team rates the LJCMG Office of Internal Audit function as “generally conforming” to the Attribute Standards, Performance Standards and the Code of Ethics. Overall, the Office of Internal Audit “generally conforms” to the *International Standards for the Professional Practice of Internal Auditing*. In addition, the QA team also rates the Office of Internal Audit as conforming to the requirements spelled out in the Generally Accepted Government Auditing Standards (see Addendum below for detail).**

Opportunities and Innovative Practice Suggestions - Summary

Opportunities and innovative practice suggestions that we believe will enhance conformity with the *Standards* and further improve the effectiveness of the Office of Internal Audit are summarized below.

Opportunities to Improve Conformity with IIA *Standards*

1. **Consider using the IIA’s “Measuring Internal Audit Effectiveness and Efficiency” Practice Guide** to enhance the current QA&IP by applying the concepts which are focused on stakeholder satisfaction, key departmental processes, staff capabilities, and on-going technological innovations. (*Standards* 1310 & 1311 – Requirements for the QA&IP & Internal Assessment)
2. **Communicate the results of the OIA Quality Assurance and Improvement Program (QA&IP)** to management and the GAEC at least annually. (*Standard* 1320 - Reporting on QA&IP)
3. **Develop comparative reporting information** to enhance communication with management and GAEC by periodically including further information in the committee’s reporting package on performance relative to the OIA approved engagement, financial, and resource plans. (*Standard* 2060 – Reporting to Senior Management and the Board)
4. **Enhance engagement supervision documentation** to ensure objectives are achieved, quality is assured, and staff is developed. (*Standard* 2340 – Engagement Supervision)
5. **Enhance the engagement level risk assessment process documentation** to include consideration of all risks associated with the involved auditable unit(s). (*Standard* 2210.A1 - Engagement Objectives)
6. **Issue reports in a timely manner** to assure engagement results are communicated promptly. (*Standard* 2420 – Quality of Communications)



7. **Re-evaluate the OIA criteria for scheduling follow-up** efforts on audit recommendations to assure complete and timely implementation has taken place. (*Standard 2500 - Monitoring Progress*)
8. **Utilize the comprehensive audit risk assessment methodology spelled out in the OIA Audit Manual** to develop and present an annual audit plan that focuses on LJCMMG highest risk auditable units. (*Standard 2010 - Planning*)

Innovative Practice Suggestions for Consideration by OIA

1. **Develop a department level competency model** to clearly articulate the skill-sets and professional knowledge required to carry out the OIA mission and satisfy the expectations of its stakeholders. (Innovative Practice) (*Standard 1210 – Proficiency*)
2. **Perform a staffing analysis based on the risk assessed audit universe** that helps enhance oversight of the OIA's on-going resource levels. (*Standard 2030 - Resource Management*)
3. **Develop written OIA internal policies regarding:**
 - Engagement Disclosure of Nonconformance with *the Standards*, Code of Ethics or Definition of Internal Auditing (*Standard 2431 - Engagement Disclosure of Nonconformance*)
 - Errors and Omissions in audit Reports (*Standard 2421 - Errors and Omissions*)
 - Management acceptance of risk (*Standard 2600 - Resolution of Senior Management Acceptance of Risks*)
4. **Complete the automation of an electronic work paper system** using Microsoft Office Suite, along with SharePoint software to create, organize, share and retain all working paper documentation. (Innovative Practice)


Innovative Practice Suggestions for GEAC and Management Consideration

1. **Strengthen the Louisville Jefferson County Metro Government's oversight of the Office of Internal Audit** by establishing an separate advisory committee to handle the functional reporting roles and responsibilities of a more independent audit committee such as: (*Standard 1110 - Organizational Independence* and *Standard 1111 - Direct Interaction with the Board*)
 - Approval for the selection and removal of the CAE
 - Approval of the annual audit engagement plan or significant subsequent changes
 - Approval of financial and resource budget or significant subsequent changes
 - Approval of the CAE compensation and performance evaluation

Additional detail about the previously listed opportunities and innovative practices is provided in the Report Detail section that follows this Executive Summary.

Thank you again for the opportunity to provide you with our quality assessment services.

Respectfully,



Brian E. Kruk
Senior Director Quality & Risk Services

Team Member:

David Walsh III – QA Consultant

Richard Epping - QA Consultant



HONKAMP KRUEGER & CO, P.C.

CPAs & Business Consultants

Report Detail

Opportunities to Improve Conformity with IIA Standards

Observations	Recommendations	OIA Responses
<p>1. Consider using the IIA's "Measuring Internal Audit Effectiveness and Efficiency" Practice Guide (December 2010) – The OIA has taken steps to establish some internal assessment processes that moved it towards general conformity with IIA <i>Standard</i> 1310 and 1311. These steps include establishing and tracking periodic metrics and periodic self-assessment of the OIAs conformity with IIA <i>Standards</i>. These exercises are notable innovative practices and should be continued going forward.</p> <p>The OIA has opportunities, however, to enhance and right-size its formalized internal QA&IP. These opportunities are discussed in a framework that is covered in the IIA's recently issued <i>Practice Guide - Measuring Internal Audit Effectiveness and Efficiency</i>. This framework discusses the use of general concepts such as stakeholder satisfaction, key audit processes, audit staff capabilities, and technological innovation to create a robust, right-sized QA&IP program to meet the specific needs of an internal audit activity.</p>	<p>The OIA should enhance its current QA&IP by considering the techniques outlined in the new IIA Practice Guide. The resulting program should be tailored to fit the situation, involve all members of the OIA, and help provide assurance that the OIA is following its own policies and procedures, while meeting the expectations of senior management and the Government Accountability and Ethics Committee (GAEC) as it maintains general conformity with the IIA <i>Standards</i> and Code of Ethics.</p> <p>Components of the QA&IP should consider stakeholder satisfaction, key audit processes, staff capabilities, and technological innovation, while bringing focus on managing and improving all OIA processes. (<i>Standard</i> 1311 – Internal Assessment)</p>	<p>In March 2010, the OIA supervisory staff performed a self-assessment evaluation of the Quality Assurance Improvement Program (QA&IP). The purpose was to identify areas in which enhancements to the QA&IP could be beneficial to the office.</p> <p>The Office of Internal Audit (OIA) will use the IIA's "Measuring Internal Audit Effectiveness and Efficiency" to enhance the current QA&IP to include all staff and establish performance measurement and monitoring processes. This will include components that consider stakeholder satisfaction and provide assurance that the Office of Internal Audit is performing in an effective and efficient manner while adhering to internal policies and procedures. This assessment will be performed annually.</p>
<p>2. Communicate the results of the OIA Quality Assurance and Improvement Program (QA&IP) - As noted in the prior observation the OIA has created procedures establishing some internal assessment processes that moved it into conformity with IIA <i>Standard</i> 1311. The OIA has however, not established a formal approach on reporting the results of its QA&IP to senior management and the GAEC as required by <i>Standard</i> 1320 - Reporting on QA&IP.</p>	<p>The CAE should formalize a process to report the results of the OIA's QA&IP efforts at least annually to senior management and the GAEC. (<i>Standard</i> 1320 - Reporting on QA&IP)</p>	<p>The Office of Internal Audit's QA&IP will be thoroughly documented and the results will be communicated annually to both the Mayor and Metro Council as required by <i>Standard</i> 1320. The results will include the reviewer's assessment with respect to the degree of conformance.</p>



<p>3. Develop comparative reporting information to enhance communication with the GAEC and management – <i>Standard 2060</i>, states that “the CAE should report periodically to the board and senior management on an IA activity’s performance relative to its plans”. Our review of GAEC presentation materials found it to be reasonably robust and professionally prepared. Review also indicated however, that performance relative to approved annual plans and other key OIA operating metrics are not included in the reporting packages.</p> <p>Additionally, we noted that information regarding the usage of audit resources by major categories such as: financial, operational, IT, compliance, or special projects is not provided. Internal audit groups typically track resource usage and at a minimum provide their oversight committees with a comparison of how audit resources are being applied with respect to a pre-approved plan. This affords the committee an oversight opportunity on a macro-level.</p>	<p>The OIA should enhance its reporting to the GAEC and management and periodically include further comparative information in its reporting packages on its performance relative to engagement, financial, and resources plans. Additionally, as operating metrics are developed in response to our QA&IP recommendation, appropriate key metrics should be included in the periodic GAEC presentations.</p> <p>We also suggest the CAE use the detailed tracking of audit resource usage by major category to develop and include comparative usage metrics or a pie chart presentation in the OIA periodic GAEC reporting packages. (<i>Standard 2060 – Reporting to the Board and Senior Management</i>)</p>	<p>Performance data is presented in several different report formats, including the annual report of activities and the audit plan. These reports are communicated to the Mayor and Metro Council. However, comparative information on OIA’s performance relative to engagement, financial, and resources plans is not included in the reports. The Office of Internal Audit will consider incorporating a comparative analysis into the annual report of activities. The analysis will inform the Mayor and Metro Council of significant deviations from the audit plan, staffing plans, and financial budgets.</p>
<p>4. Enhance engagement supervision - <i>Standard 2340</i>, states that “engagements should be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.” Related Practice Advisories provide guidance emphasizing the need for on-going, complete, timely and thus effective work paper review. The intent is to assure that adequate and appropriate documentation exist to clearly demonstrate and support all audit observations and recommendations.</p> <p>Our review of work papers and discussion with staff indicated that the role of completing final supervisory review and sign-off for all audit work is being accomplished although timeliness has been an issue. We also determined that while on-going supervision efforts were a little less robust than expected it was taking place through periodic scheduled feedback sessions. In many instances no</p>	<p>The extent of supervision required will always depend on the proficiency and experience of the auditors performing the work and the complexity of an engagement. With this in mind, we suggest that additional documentation of on-going supervision and review of work papers is necessary to establish compliance with <i>Standard 2340</i>. This review can be accomplished by the OIA supervisory staff or by delegation to appropriately experience staffers. Whatever approach is decided upon should provide for standardized evidence being documented and retained in the individual work paper files. (<i>Standard 2340 – Engagement Supervision</i>)</p>	<p>Internal quality assurance reviews are performed at the completion of the auditor’s field work. These reviews are thoroughly documented through the use of project review notes. These are normally prepared when a portion of the audit project has been completed and ready for final review. Supervisory involvement throughout the audit project is provided in order to ensure engagement objectives are met and determining work papers adequately support engagement observations, conclusions, and recommendations.</p> <p>The OIA supervisory staff or appropriately experienced staffers will begin to include documented evidence of on-going supervision in the work papers. Review notes will not only be prepared at the completion of field work but will also be prepared to record issues that might need clarification or follow - up attention while the audit</p>

<p>indication of this on-going supervision could be found in the work papers.</p>		<p>project is still underway. As the auditor's level of experience and proficiency increases the extent of supervision throughout the audit process will decrease.</p>
<p>5. Enhance the engagement level risk assessment process documentation - Standard 2210.A1 states: "Internal auditors must conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives must reflect the results of this assessment." During our review of audit work papers, we noted that the OIA auditors include a standardized work paper section devoted to documenting the required pre-engagement planning efforts. This evidence typically included identified risks determined through discussions with the internal client and the auditors own understanding of the auditable unit. The work paper section also typically included discussion on the fraud risk that was considered. The approach to preliminary planning notably is structured and well documented.</p> <p>One additional step commonly used by best in class audit groups involves the listing and ranking of the identified risks. This planning step provides for an assessment of the likelihood and impact of each risk. By using these numeric scores, consideration can be given to each risk, in regards to the need for testing, as the auditor works towards finalizing the engagement work plan. OIA does not currently complete this type of exercise in its pre-planning process.</p>	<p>OIA should enhance its engagement level planning and work paper content to include a clear description and ranking of all risks identified in the preliminary planning exercise. Using input from management, OIA existing knowledge of the area being audited, and the total results of the engagement level risk assessment process OIA can identify the most significant engagement level risks and focus it's resources appropriately. (Standard 2210.A1 - Engagement Objectives)</p>	<p>Prior to the start of field work, the auditor completes a preliminary risk assessment work paper to document risks identified through discussions with the client and the auditor's knowledge of the auditable unit.</p> <p>The Office of Internal Audit will enhance the preliminary risk assessment to include a listing and ranking of the identified risks. The ranking will be used to identify significant risks and determine where to appropriately focus our resources. Engagement objectives will reflect the results of the assessment.</p>
<p>6. Issue reports in a timely manner - Standard 2420 states: "Communications should be accurate, objective, clear, concise, constructive, complete and <u>timely</u>." During our review of work papers and an examination of the OIA Activity Report, we noted that the time it took to issue a final report is longer than historical averages available to us through the</p>	<p>OIA should begin monitoring key cycle time metrics. Frequently used interim cycle time metric measurements are from auditor assignment to the end of planning, from the end of planning to the end of fieldwork, from the end of fieldwork to the issuance of a draft report and from the issuance of the draft report to the issuance of the final report.</p>	<p>The Office of Internal Audit understands the necessity of issuing reports in a timely manner. The value of the report results are diminished if the report is not distributed to the Mayor and Metro Council in a timely manner. Timely communications are opportune and expedient allowing management to take appropriate corrective action.</p>



<p>Global Audit Information Network (GAIN) survey data. For example, for the number of days from the completion of work paper reviews to the completion of the draft reports for 2010 and 2011 averaged 67 and 48, respectively while GAIN averages for the total universe was 25 days. We also noted a longer than expected time period between draft report issuance and final report issuance with the two year averages about the same at 34 days, while GAIN reported a comparable 13 days.</p> <p>Further discussion pointed out that no metric for report turnaround has been established. OIA does record appropriate critical dates that could be used to track various cycle times such as end of field work to draft report or from draft report to final report. Without this tracking, there is no way to monitor the timeliness of report issuance or measure the IA activity's effectiveness against the <i>Standard</i> requirements for timeliness.</p>	<p>Monitoring these types of milestones throughout the audit process helps management recognize bottleneck issues and allows action to be taken to reduce overall cycle time. To start, the CAE should at least monitor the time from the end of field work to issuing a draft report and from the draft report to issuing the final report. (<i>Standard</i> 2420 – Quality of Communications)</p>	<p>The Office of Internal Audit currently uses an Audit Time work paper which is used to track the hours dedicated to a project. At the completion of an audit project, a summary of time spent conducting the project work is included in the Audit Time work paper. The summary includes resources for any internal audit staff who participated in the audit project.</p> <p>The Audit Time work paper will be revised to include key milestones during the audit process. These milestones will include the following dates; assignment notification date, engagement letter date, entrance conference date, engagement program completion date, end of fieldwork date, fieldwork reviewed date, review notes cleared date, draft report issued date, exit conference date, corrective action responses received date, and final report issued date. Comparisons of these dates will be performed in order to monitor these milestones throughout the audit process and assist management in identifying and addressing bottleneck issues.</p>
<p>7. Re-evaluate the OIA criteria used for scheduling follow-up efforts on audit recommendations – <i>Standard</i> 2500.A1 states that “the chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.”</p> <p>During our review it was pointed out that the OIA records all audit recommendations in the IA Office Activity spreadsheet. On an annual basis, an email is sent to the appropriate parties requesting the audit client to provide OIA a status on their implementation efforts. From responses to these emails an annual report, titled Audit Follow-up Report, is prepared for the Mayor and shared with</p>	<p>We recommend the OIA rethink its approach to follow-up and consider conducting formal follow-up efforts on at least on a quarterly basis to assure management's agreed upon action plans, provided in audit reports, are effective and timely carried out. Instances where management implementation efforts are being ignored or continually pushed out should be escalated to the Mayor's Office and GAEC based on a predetermined policy established by the CAE.</p> <p>This approach combined with strong management and GAEC support that continued failure to implement agreed upon actions and repeat audit observations will not be tolerated can be used as an extremely effective method to assure that implementation of corrective action has taken place.</p>	<p>The Office of Internal Audit performs an annual follow up on major audit recommendations to determine if corrective actions have been implemented and are effective. Management is requested to provide information on the status of their corrective action plans. Based on the information provided, OIA determines the status of the corrective action (e.g., some corrective action implemented, client assuming the risk). Auditing of the area is not performed until the next scheduled engagement.</p> <p>The Office of Internal Audit will consider a more aggressive follow up approach to assure that management's agreed upon action plan is implemented and effective. OIA will inform the Mayor and Metro Council of any instances where</p>



<p>the GAEC. Typically, no verification of client responses are performed until the next audit of the area is conducted and no actions beyond reporting the status in the annual report are taken to escalate delinquent open issues for management and GAEC consideration.</p> <p>The <i>Standards</i> emphasize that follow-up is an important internal audit responsibility. In support of this premise, Practice Advisory 2500.A1-1 Paragraph #2 states that “follow-up is a process by which internal auditors evaluate the <u>adequacy, effectiveness, and timeliness of actions taken by management</u> on reported observations and recommendations. Accordingly, in our experience, follow-up and where appropriate, implementation testing, is typically conducted on a more frequent basis to assure agreed upon risk mitigation (control implementation) efforts have been carried out in an effective, and most importantly, in a timely fashion.</p>	<p>(<i>Standard</i> 2500A.1 – Monitoring Progress)</p>	<p>implementation efforts are being ignored or pushed out; and management’s acceptance of risk is too large for Metro’s risk appetite.</p>
<p>8. Simplify and enhance the current audit universe and annual risk assessment process - <i>Standard</i> 2010 states that “the CAE is required to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.” Also, <i>Standard</i> 2010.A1 further states that plan of engagements must be based on a documented risk assessment, undertaken at least annually. (<i>Standard</i> 2010.A1)</p> <p>To comply with the IIA <i>Standards</i> the OIA has created what we believe to be an unusually large audit universe consisting of 844 auditable units. This is the result of auditable units being defined using extremely narrow scopes. For example, OIA has identified 19 auditable units that deal in some form or fashion with payroll processing. Most audit universes and corresponding risk assessments would include the payroll process as one auditable unit, unless payroll processing varied widely across the organization or perhaps used different</p>	<p>We suggest that OIA consolidate its universe of auditable units and simplifying its current risk assessment process by including fewer subjective risk factors and more objective risk factor into to its model. We believe this simplification will benefit OIA by enhancing its ability to communicate the assessment results to the GAEC and management while facilitating a clearer linkage between the audit universe, its risk assessment and the OIA proposed annual audit plan.</p> <p>A typical internal audit activities risk assessment process is accomplish in two primary steps. The first step involves creating a universe of auditable units. The second step is to develop a risk assessment model that ranks the auditable units through the application of determinable weighted risk factors that are adjusted periodically based on a predetermine set of criterion.</p> <p>An audit universe is typically the aggregate of all</p>	<p>The Chief Audit Executive prepares a one to five year audit plan for the Office of Internal Audit. The audit universe is compiled by identifying all auditable units / entities of Louisville Metro Government. After OIA’s audit universe is created, risk factors are determined and applied to the auditable units using the COSO Risk Management framework.</p> <p>The Office of Internal Audit will modify the audit universe by combining similar auditable units defined using narrow scopes into one auditable unit defined using a broader scope. OIA will also attempt to use more objective risk factors in the assessment process in order to provide a clearer linkage between the audit universe, its risk assessment and the OIA proposed annual audit plan.</p>



<p>processing software system all together.</p> <p>In establishing its approach, the OIA may have also over complicated its risk assessment process by using 11 subjective risk factors derived primarily from the COSO Model to rank the universe's auditable units. An example of a subjective risk factor might be the CAE's evaluation of changes in management of the auditable unit. The disadvantage of using subjective risk factors is that another person's evaluation of the subjective risk is based on that person's background and risk appetite. This makes it unlikely that any two people would arrive at the same risk ranking for an auditable unit. The advantage of using more objective risk factors is that different people are likely to come to the same, or close to the same ranking. An example of an objective risk factor might be the absolute value of the auditable unit's revenues and/or expenditures.</p>	<p>areas that are available to be audited within the organization. To create an audit universe the CAE segregates the organization into manageable auditable activities (auditable units). An auditable unit may be defined a variety of ways, such as by function or activity, by organizational unit or division, or by project or program. Depending on the size and complexity of the organization, the audit universe varies somewhat, but is generally between 100 and 300 auditable units for an organization the size of LJCMG.</p> <p>After creating the audit universe, the CAE develops risk factors to apply to the auditable units through an organized risk assessment model so that the auditable units can be ranked from highest to lowest risk. Most risk assessments use both objective and subjective risk factors. Selecting risk factors applicable to the organization makes each risk assessment unique and results in fewer risk factors being necessary. Typical risk assessments utilize six to eight risk factors that are usually weighted by relative importance. (<i>Standard 2010 - Planning</i>)</p>	
--	---	--



Innovative Practice Suggestions for the OIA Consideration

Observations	Recommendations	OIA Responses
<p>1. Develop a department level competency model - OIA demonstrated that individual position competency levels are considered in its short and long range planning efforts as position descriptions were provide for our review. A formalized, departmental level Competency Model has, however, not been prepared.</p> <p>An articulated up-to-date departmental level model helps ensure that all necessary skills, required to accomplish its mission, have been identified and that OIA management is continuously considering steps to ensure that those skills are available or are being developed. Most internal audit activities need skill-sets in the disciplines of finance, accounting, auditing, project management and IT to properly accomplish their mission and business objectives. Where appropriate, these skill-sets are also typically recognized by other areas of an organization as valuable for future personnel development and rotation.</p>	<p>The CAE should consider developing a departmental level Competency Model to clearly articulate the skill-sets and professional knowledge required to adequately carry out the group's mission and satisfy the expectations of its stakeholders. (Innovative Practice related to <i>Standard 1210 - Proficiency</i>)</p>	<p>The Office of Internal Audit collectively possesses the knowledge and skills essential to the practice of the profession within Louisville Metro Government. A Competency Model will be developed to determine the skill - set and professional knowledge required to satisfy the expectations of the Mayor and Metro Council as conveyed in our charter. A periodic analysis of OIA's knowledge, skills, and other competencies will be performed in order to identify areas of opportunity that can be addressed by continuing professional development, recruiting, or co-sourcing.</p>
<p>2. Perform a staffing analysis based on the comprehensive risk assessed audit universe - The process of determining staffing levels for the OIA is one of best judgment. OIA has not performed a staffing analysis based on the universe of auditable units. Although interviews indicated that the GAEC regularly inquires about the sufficiency of resources, the lack of a staffing analysis may have limited the Committee's ability to make a judgment on resource adequacy.</p> <p>Best-in-class audit departments typically add to the process of determining appropriate staffing levels by performing an analysis based on the comprehensive risk based audit universe. While this process is not foolproof due to the use of assumptions and estimates in the calculations such</p>	<p>The CAE should perform a staffing analysis based on the risk assessment of the audit universe and present the results to management and the GAEC to help validate the OIA's current level of staffing resources. The analysis can clearly demonstrate audit areas (risks) that are intentionally excluded from or delayed in the proposed audit plans because of resource limitations. Such data will afford both management and the GAEC the opportunity to enhance their oversight of OIA. (<i>Standard 2030 – Resource Management</i>)</p>	<p>Subsequent to the issuance of the annual plan, the CAE will prepare a staffing analysis in order to provide the Mayor and Metro Council a basis for making more informed judgments on the sufficiency of existing staffing levels.</p>



as; hours needed to complete an audit, auditable unit cycle times, and risk rating assignments, it does provide management and oversight committees a basis for making more informed judgments on the reasonability of existing staffing levels.		
<p>3. Develop written OIA internal policies - Four instances were noted where the OIA had clearly articulated, but had not documented, what it would do in the unlikely event of issues arising around the following circumstances:</p> <ul style="list-style-type: none"> • Errors and omissions in audit reports • Engagement disclosure of non-conformance • Management acceptance of risk <p>Procedures and action steps covering these unlikely situations are typically documented in internal audit P&P Manuals to provide consistent, timely, actionable responses to each.</p>	<p>OIA should develop and document written policies and procedures for inclusion in its Policy and Procedure Manual to deal with any future occurrences of these situations:</p> <ul style="list-style-type: none"> • Errors and omissions in audit reports (<i>Standard 2421</i>) • Engagement disclosure of non-conformance (<i>Standard 2431</i>) • Management acceptance of risk (<i>Standard 2600</i>) 	<p>The Office of Internal Audit will revise their existing Policy and Procedure Manual to include consistent, timely, action responses to the following unlikely situations:</p> <ul style="list-style-type: none"> • Errors and omissions in audit reports (<i>Standard 2421</i>) • Engagement disclosure of non-conformance (<i>Standard 2431</i>) • Management acceptance of risk (<i>Standard 2600</i>) <p>Responses will be developed to address the above situations and will be documented in the Policy and Procedure Manual. The revised manual will be distributed to all applicable personnel.</p>
<p>4. Complete the automation of an electronic work paper system - OIA has several times in the past considered purchasing and installing an automated work paper system. Budget constraints along with other priorities have prevented the department from moving forward with this idea. Being proactive, OIA has however implemented a program making it standard procedure for all work paper documentation to be backed up electronically on a CD. This CD is then retained in a plastic sleeve along with a hardcopy Table of Contents in the hardcopy binders.</p> <p>As a result of these efforts to organize this record retention process OIA has essentially created a structured electronic work paper filing system.</p>	<p>We recommend that OIA evaluate its opportunity to create a Microsoft Office Suite based solution, to create, organize, share and retain its working paper documentation. Having created or solved the issues around preparing and creating all the necessary electronic records (spreadsheet, WORD docs, HTML, PDF, hyperlinks, etc.) OIA can pursue the use of the internally available Microsoft SharePoint software recently acquired by LJCMG. SharePoint can be utilized to provide the document sharing and access records providing the capability to track supervisory review and approvals in a fashion similar to that provide in a third party developed audit management system. (Innovative Practice)</p>	<p>OIA will evaluate feasibility of utilizing the Microsoft Office Suite to enhance our existing electronic work paper filing system. OIA will look into communicating with peer audit shops to understand how Microsoft SharePoint was incorporated to facilitate the sharing of documents, accessing records and tracking supervisory review and approvals.</p>



Innovative Practice Suggestions for GAEC and Management Consideration

Observations	Recommendations	GAEC & Management Responses
<p>1. Strengthen the Office of Internal Audit oversight environment and enhance its independence by establishing an advisory committee - The clear understanding of a functional reporting relationship between an internal audit activity and its oversight committee is often difficult to communicate to all stakeholders of the department. Functional reporting is best described by the interpretative language provided in IIA <i>Standard</i> 1110 - Organizational Independence. This language reads as follows:</p> <p>Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:</p> <ul style="list-style-type: none"> • Approving the internal audit charter; • Approving the risk based internal audit plan; • Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters; • Approving decisions regarding the appointment and removal of the chief audit executive; and • Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scopes or resource limitations. <p>These oversight committee responsibilities are considered by the profession to be the cornerstones of a solid functional reporting relationship. They strengthen independence by providing the necessary functional oversight for the scope of proposed work and any limitations placed on that scope, while being recognized as innovative</p>	<p>We suggest it is possible to strengthen the current governance situation and establish a clearer functional reporting relationship for the OIA through the creation of an advisory committee. This committee could be given the functional reporting responsibilities described in our observation and would be comprised of appointed members from the Council, the Mayor's Office and possibly local outside independent Subject Matter Experts. A committee such as this would provide the safeguards against the potential perception of a lack of independence or undue influence issue in the future, thus strengthening the overall governance environment with respect to the OIA.</p> <p>Precedence has been set for the establishment of this type of oversight committee. We refer to the legislation and resulting establishment of such a committee called the Internal Audit Board, by the City of Lexington, Kentucky and to guidance published by the Association of Local Government Auditors entitled Model Legislation Guidelines for Local Government Auditors, 3rd Edition 2007.</p> <p>(Innovative Practice Associated with <i>Standard</i> 1110 - Organizational Independence & <i>Standard</i> 1111 - Direct Interaction with the Board)</p>	<p>Louisville Metro Government's audit committee is a standing committee of the Metro Council. The Governmental Accountability and Ethics Committee is comprised of elected Council officials and provides a forum for assessing the City governmental functions, risks, resource allocations, financial reporting and auditing.</p> <p>The Office of Internal Audit supports the concept of an advisory committee to strengthen the current governance and reporting structure. The Office of Internal Audit will discuss the concept with both the Mayor and Metro Council to determine the necessity of establishing an advisory committee.</p>



<p>governance practices.</p> <p>The legislation that established the OIA, Codified Ordinance 30.30-45, states “the Office of Internal Audit shall be separate from any other agency or department of Louisville/Jefferson County Metro Government and shall report directly to the Mayor (Executive Branch) and to the Council (Legislative Branch).” Subsequent to this legislation the Council established a standing committee called the Government Accountability and Ethics Committee (GAEC) to function as an intermediary between the Council and the OIA. Under the current legislation the Council and the Mayor’s Office share certain responsibilities for oversight of the OIA. At the same time, both have direct managerial control for auditable units in the audit universe subject to audit by the independently established OIA.</p> <p>Although the legislation calls for the OIA to be separate from the other agencies or departments it calls for a direct dual reporting relationship to the Council and the Mayor. This combined with the direct managerial authority over auditable units by both the Council and the Mayor’s Office in our opinion could potentially cause a perceived impediment to the OIA organizational independence.</p>		
--	--	--

Addendum



HONKAMP KRUEGER & CO, P.C.

CPAs & Business Consultants

Government Auditing Standards External Peer Review Report

***For the
Louisville Jefferson County
Metro Government
Office of Internal Audit
December 5, 2011***

Introduction

At the request of the Louisville Jefferson County Metro Government, Honkamp Krueger & Co., P.C. has completed an External Peer Review of your Office of Internal Audit (OIA) required by Government Auditing Standards – 2007 Revision (GAS). We appreciate the opportunity to present the results of our Review in the narrative which follows.

OIA currently consist of 8 full-time professionals, including the Director of OIA (Chief Audit Executive or CAE). The CAE reports to the Metro Council and the Mayor. The CAE and his staff of seven audit professionals are responsible for conducting audits of all departments, offices, boards, activities and agencies of the Louisville/Jefferson County Metro Government.

OIA is currently pursuing the satisfaction of the Government Auditing Standards - Revision 2007, most often referred to as the Generally Accepted Government Auditing Standards (GAGAS), requirement that an External Peer Review of its auditing engagement practices be conducted at least once every three years by an independent reviewer.

The Honkamp Krueger Solution

Honkamp Krueger, a professional provider of internal audit services, was engaged to conduct the required External Peer Review. The Review covered audits performed during the last twelve months. The Review's objective was to conduct a sufficiently comprehensive evaluation of the OIA established quality control system (policies and procedures) and the capabilities of the professional staff to facilitate its proper application. The evaluation of these attributes provides a reasonable basis for concluding whether the system was complied with, in a fashion that allowed OIA reasonable assurance regarding its conformity with GAGAS. The review included developing an understanding and an evaluation of:

- the established quality control process
- the methodology to assure the identification and elimination of any impairments to independence
- the professional proficiency of the staff and external vendors
- the application of professional judgment, when needed

Acting as the Peer Reviewer, Honkamp Krueger is fully independent of OIA and has the necessary knowledge, skills and credentials to undertake this engagement. No limitations were involved in the execution of our work.


Conformity Opinion

It is the opinion of the Honkamp Krueger External Peer Review team that the Louisville Jefferson County Metro Government Office of Internal Audit has an established, robust system of quality control that has been used to review its auditing engagements. Additionally, it is our opinion that the system has been complied with during the period under review, therefore providing reasonable assurance that OIA is conforming to the professional standards as called for by GAGAS except for not having completed a peer review three years after the last peer review was performed.

Thank you again for the opportunity to be of service conducting your GAGAS based External Peer Review. If we can be of any further assistance, please don't hesitate to call.

Respectfully Submitted,

HONKAMP KRUEGER & CO., P.C.



Brian E. Kruk, MBA, CIA, CISA, CCSA, CGAP
Peer Review Team Leader
Senior Director - Quality Assessment and Risk Services